

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**THE WORKING CAPITAL FUNDS INTERIM
MIGRATORY ACCOUNTING STRATEGY**

Report No. 98-014

October 24, 1997

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Acronyms

CFO	Chief Financial Officer
DBMS	Defense Business Management System
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
WCF	Working Capital Funds



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October 24, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on the Working Capital Funds Interim Migratory Accounting Strategy (Report No. 98-14)

We are providing this report for review and comment. The Under Secretary of Defense (Comptroller) did not respond to the draft report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Based on discussions with personnel from the Office of the Under Secretary of Defense (Comptroller), we deleted draft Recommendation 1. and renumbered draft Recommendations 2. and 3. accordingly. We request that the Under Secretary of Defense (Comptroller) provide comments on the recommendations by January 9, 1998.

The courtesies extended to the audit staff are appreciated. If you have questions on this audit, please contact Mr. Richard B. Bird, Audit Program Director, at (703) 604-9175 (DSN 664-9175) or Mr. John J. Victor, Audit Project Manager, at (317) 542-3855 (DSN 699-3855). Appendix D lists the planned distribution of this report. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-14

(Project No. 6FI-2012)

October 24, 1997

The Working Capital Funds Interim Migratory Accounting Strategy

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an annual audit of the financial statements of trust and revolving funds, such as the Defense Business Operations Fund. We have conducted audits of the Defense Business Operations Fund since 1992 and have been unable to render audit opinions because of significant deficiencies in at least 82 accounting systems and numerous feeder systems that support the fund and because of the lack of a sound management control structure. In FY 1996 the Defense Business Operations Fund reported total assets of \$92.2 billion.

The Defense Finance and Accounting Service established, and the Defense Business Operations Fund Corporate Board approved, the Defense Business Operations Fund Interim Migratory Accounting Strategy (the Strategy) in February 1994 to decrease the number of accounting systems that support the fund and to correct the deficiencies in the accounting systems selected for retention. The Strategy was to be implemented in two phases. The first phase, the Interim Migratory Accounting Strategy, was to reduce the number of accounting systems from 82 to 17 and at the same time, correct the accounting system deficiencies. The second phase of the strategy was to transition from the 17 interim migratory accounting systems to a smaller, but undetermined, number of migratory accounting systems. No time frames were established for Phase I or Phase II.

The Under Secretary of Defense (Comptroller) announced in December 1996 that the Defense Business Operations Fund would be replaced by several working capital funds. The 13 business areas under the Defense Business Operations Fund were restructured under the Military Service or Defense agency Working Capital Funds. The name has now been changed to the Working Capital Funds Interim Migratory Accounting Strategy (the Strategy).

Audit Objective. The audit objective was to evaluate the Working Capital Funds Interim Migratory Accounting Strategy established by the Defense Finance and Accounting Service and approved by the Defense Business Operations Fund Corporate Board. We reviewed the completeness of the strategy and the reasonableness of the time frames and cost estimates for achieving auditable Working Capital Funds financial statements that comply with the Chief Financial Officers Act. We did not review the management control program as it related to the WCF accounting systems because required financial statement audits provide sufficient coverage of the WCF management control program. Additionally, the objectives concerned planning and policy issues rather than control techniques.

Audit Results. The Defense Finance and Accounting Service made progress in reducing the number of accounting systems that support the Working Capital Funds. The continued elimination of accounting systems will allow the Defense Finance and

Accounting Service to reduce system operating costs and minimize funds needed to correct accounting system deficiencies. However, the Interim Migratory Accounting Strategy has been significantly modified since its February 1994 inception. Of the original 17 systems selected as interim migratory accounting systems, 3 have been redesignated as legacy systems (a legacy system is an existing automated information system that has not been selected for long-term use), 5 are being reconsidered for inclusion in the Strategy, 2 are being studied for possible merger, and 3 will have to change their original approach to system enhancements. These modifications were made to accommodate various Military Service and Defense agency initiatives and to identify more efficient options to meet accounting system requirements. Also, the Strategy did not include all the systems that supported the various business areas. Until the Strategy is updated, final accounting system selections are made, and all feeder systems are included as part of the Strategy, the time frames and costs are unknown for achieving accounting systems that comply with the Chief Financial Officers Act and the Federal Financial Management Improvement Act of 1996 and for producing auditable financial statements. Auditable financial statements will only be possible through the joint efforts of the Defense Finance and Accounting Service, the Military Services, and Defense agencies to correct deficiencies in all accounting and feeder systems. Part I of this report provides the details of our audit.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) finalize selection of the Working Capital Funds interim migratory accounting systems and update detailed plans, including cost estimates and time frames, to implement the systems selected for long-term use; and, in coordination with the DoD Chief Information Officer and DoD functional managers, update the Strategy to include detailed plans to correct all Military Service and Defense agency feeder systems that support each Working Capital Funds business area.

Management Comments. The Under Secretary of Defense (Comptroller) did not respond to a draft of this report issued on June 13, 1997. We request the Under Secretary of Defense (Comptroller) provide comments in response to the final report by January 9, 1998.

Actions Taken to Strengthen Strategy. Since the completion of our audit field work in March 1997, the Defense Finance and Accounting Service has taken actions to strengthen the Strategy. Personnel from the Defense Finance and Accounting Service informed us they devised a four-part strategy to bring DoD financial management systems into compliance with Federal requirements. These plans are to include enhancements to both accounting and feeder systems.

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Part I - Audit Results

Audit Background

Establishment of the Working Capital Funds. The Defense Business Operations Fund (DBOF) was established by Congress on October 1, 1991, by combining industrial, stock, and other funds operated by the Military Services and Defense agencies. The Under Secretary of Defense (Comptroller) announced in December 1996 that the DBOF would be replaced by several Working Capital Funds (WCF). The 13 business areas under the DBOF were restructured under the Military Services and Defense agencies WCF. The name has now been changed to the Working Capital Funds Interim Migratory Accounting Strategy (the Strategy). The five WCF established are:

- o the Army Working Capital Fund,
- o the Navy Working Capital Fund,
- o the Air Force Working Capital Fund,
- o the Defense-wide Working Capital Fund, and
- o the Defense Commissary Agency Working Capital Fund.

The new structure of the WCF will provide one significant advantage over the DBOF structure because separate financial statements will be produced for each WCF. Audit opinions on the separate financial statements will only be possible after the accounting systems that support the individual WCF are corrected. Since the first DBOF financial statement audits began for FY 1992, an opinion on the financial statements was not possible until the accounting systems that supported a significant portion of the DBOF were corrected and implemented.

The DBOF will also be referred to as the WCF throughout the rest of this report.

Defense Finance and Accounting Service Responsibilities. The Chief Financial Officers Act of 1990 (the CFO Act), as amended by the Federal Financial Management Act of 1994, required an annual audit of financial statements for revolving funds, such as the WCF. The Defense Finance and Accounting Service (DFAS) was responsible for compiling the WCF financial statements.

Audit Reports Summarized Results of Previous Financial Statement Audits. Auditors have conducted financial statement audits of the WCF since FY 1992; however, in that time, they have only been able to render disclaimers of opinion. Previous IG, DoD, audit reports summarized the major deficiencies preventing DoD from producing auditable WCF financial statements. Those reports identified accounting system deficiencies as a major reason that auditors cannot render audit opinions on WCF financial statements. See Appendix B for details of the audit reports.

WCF Accounting System Improvement Initiatives. On August 28, 1992, the Acting DoD Comptroller designated the Defense Business Management System (DBMS) as the migratory accounting system for all of the DBOF. DoD pursued initiatives in FY 1992 and FY 1993 to correct the DBMS to meet CFO Act requirements. In April 1993, the Secretary of Defense directed that DBOF be reviewed and a plan developed to correct identified deficiencies and improve the overall operations, including the area of accounting systems. As a result of this review, the Deputy Secretary of Defense and the Military Department Secretaries approved the DBOF Improvement Plan on September 24, 1993. The DBOF Improvement Plan recommended the establishment of a Corporate Board to develop, review, and recommend DBOF policies and procedures to include actions to support DBOF management information systems. (The DBOF Corporate Board has been renamed the Working Capital Funds Policy Board). The DBOF Improvement Plan also directed that DoD reconsider the DBMS as the designated migratory accounting system, and recompute the accounting system selection. As a result of this reconsideration, in October 1993 the DoD Principal Deputy Comptroller redesignated the DBMS as a legacy system. A legacy system is an existing automated information system that has not been selected for long-term use. Therefore, DBMS was no longer the migratory accounting system for DBOF.

Establishing the WCF Accounting System Strategy. As a result of the DBOF Improvement Plan, DFAS established, and the DBOF Corporate Board approved on February 24, 1994, a two-phase accounting system strategy for the WCF. The first phase, the Interim Migratory Accounting Strategy (the Strategy) was focused around migrating to a separate accounting system for each WCF Component in each business area. A formal completion date for the Strategy was not established. The second phase was to transition from the interim migratory accounting systems to a selected number of migratory accounting systems by evaluating opportunities to use the best interim migratory accounting systems. Figure 1 depicts the Strategy initially developed in February 1994.

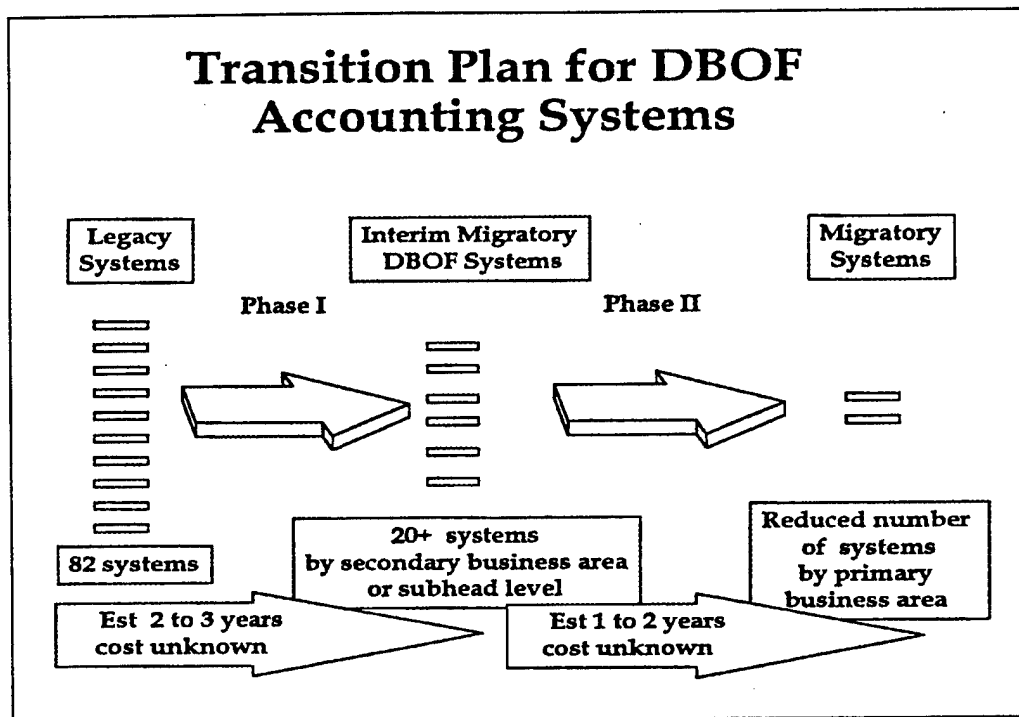


Figure 1. DFAS Transition Plan for WCF Accounting Systems

The focus of this audit was to review Phase I: the Interim Migratory Accounting Strategy.

Audit Objectives

Our audit objective was to evaluate the WCF Interim Migratory Accounting Strategy established by DFAS and approved by the DBOF Corporate Board. We reviewed the completeness of the Strategy and the reasonableness of the time frames and costs for achieving auditable WCF financial statements that comply with the Chief Financial Officers Act. See Appendix A for a discussion of the scope and methodology related to the audit objectives.

Consolidating and Correcting Working Capital Funds Accounting Systems

In 1994, DFAS and the Military Services performed an extensive review of accounting systems to select the interim migratory accounting systems. The review was established as the Defense Business Operations Fund Interim Migratory Accounting Strategy (the Strategy). Implementing the Strategy cost about \$83.5 million in FY 1995 and FY 1996. The Strategy enabled DFAS to make progress in reducing the number of WCF accounting systems by eliminating 15 legacy accounting systems. However, since its inception, the Strategy has been significantly modified and is incomplete. Approximately 76 percent of the Strategy's original accounting system selections have been questioned regarding their feasibility as interim migratory accounting systems or have had the original approach to system enhancements changed. These modifications were made to accommodate various Military Services and Defense agency initiatives and also to identify more efficient options to meet accounting system requirements. Also, the Strategy did not include all the systems that support the various business areas. Until the Strategy is updated, final accounting system selections are made, and all feeder systems are included as part of the Strategy, the time frames and costs are unknown for achieving accounting systems that comply with the CFO Act and the Federal Financial Management Improvement Act of 1996, and for producing auditable financial statements.

Management of WCF Systems

Establishing the Defense Accounting System Program Management Office. DFAS established a centralized program management structure over accounting system development and deployment. The Director, DFAS, established the Defense Accounting System Program Management Office (the Program Management Office) on May 15, 1996, to manage the consolidation and modernization of all migratory, interim migratory, and legacy accounting systems which DFAS substantially owned and operated. The long-term goals of the Program Management Office were to achieve statutory and regulatory compliance, reduce operating costs, and improve financial management reporting within DoD.

Standard Requirements for All Accounting Systems

Clinger/Cohen Act. The Clinger/Cohen Act, formerly the Information Technology Management Reform Act of 1996, requires the head of each executive agency, in consultation with the Chief Information Officer and the Chief Financial Officer to establish policies and procedures. These policies and procedures are to ensure that the accounting, financial, and asset management systems and other information systems of the executive agency are designed, developed, maintained, and used effectively to provide financial or program performance data for financial statements of the executive agency.

Federal Financial Management Improvement Act of 1996. The Federal Financial Management Improvement Act of 1996 requires each agency to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. If the head of an agency determines that the agency's financial management systems do not comply substantially with the requirements, the head of the agency, in consultation with the Director of the Office of Management and Budget, shall establish a remediation plan to include resources, remedies, and intermediate target dates necessary to bring the agency's financial management systems into substantial compliance.

Office of Management and Budget Circular A-127. The Office of Management and Budget Circular A-127 prescribes policies and standards for Federal agencies to follow in developing and operating financial management systems. Circular A-127 requires that each agency establish and maintain a single, integrated financial management system that complies with accounting principles, internal control standards, and all applicable Office of Management and Budget and Treasury requirements. The circular defines a single, integrated financial management system as a unified set of financial systems, non-financial systems, and mixed systems that are planned for and managed together, operated in an integrated fashion, and linked together electronically to provide agency-wide financial system support.

Joint Financial Management Improvement Program. The Joint Financial Management Improvement Program is a cooperative effort of the Office of Management and Budget, the General Accounting Office, and the Department of Treasury working collectively with other Federal agencies to improve financial management practices throughout the government. The Joint Financial Management Improvement Program publishes documents to provide overall objectives and strategies for achieving improved financial management. The Joint Financial Management Improvement Program has published numerous documents under their Federal Financial Management System Requirements Series including "Framework for Federal Financial Management Systems" and "Core Financial Systems Requirements" that describe the elements of a model for integrated financial management systems and the systems architecture that each Federal agency should strive for in support of all levels of management decision making and external reporting requirements.

Evaluation and Selection of Accounting Systems

The Strategy Objectives and Method of Selection. The two objectives of the Strategy were to decrease the number of accounting systems used to support the WCF and to correct the accounting system deficiencies in the interim migratory accounting systems to meet the 13 key accounting requirements established by DFAS (see Appendix C for a description of the 13 key accounting requirements). DFAS established, and the DBOF Corporate Board approved, a formal process to select the interim migratory accounting systems. The DBOF Components nominated 28 accounting systems to be considered as interim migratory accounting systems. Each accounting system and its associated suite of systems were evaluated against specific functional and technical criteria. A suite of systems was defined as one or more systems that were electronically integrated or interfaced to perform the required accounting and finance functions.

Selection Criteria. Review teams were formed to evaluate the 28 candidate accounting systems. DFAS personnel chaired seven review teams that included representatives from the DBOF Components. In FY 1994, the review teams evaluated the candidate accounting systems and their associated suite of systems against specific functional and technical criteria to identify system capabilities and deficiencies.

Functional Reviews Performed of Each Accounting System. The review teams performed functional reviews for each accounting system. Representatives from DFAS and the DBOF Components developed a standard functional requirements document that was used to score each accounting system for functional capabilities and deficiencies. The functional requirements document identified core WCF functional capabilities that a system should possess in order to meet all WCF accounting and reporting requirements. The functional requirements document was categorized into eleven functional areas. These areas were: (1) Fund Distribution, (2) General Ledger, (3) Fixed Assets, (4) Cost Accounting, (5) Payables, (6) Receivables, (7) Billing, (8) Disbursing/Collections, (9) Inventory Accountability, (10) Travel, and (11) General System Features.

The review teams visited an operational site for each nominated accounting system to review its functional capabilities against the standard functional requirements document. The review teams only graded the accounting systems' abilities to meet DBOF accounting requirements and did not consider future enhancements. For the areas where the system was deficient, the system central design activities estimated the time frames and costs to bring the system up to minimum standards.

Technical Reviews Performed of Each Accounting System. The central design activities also performed technical reviews to identify the technical strengths and weaknesses of each system. Personnel from DFAS and the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) developed a technical requirements document. The technical requirements document identified the technical features needed in an interim migratory accounting system. The technical requirements document was forwarded to the central design activities for all

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the accounting systems. The central design activities were instructed to rate their system against the individual requirements in the technical requirements document. DFAS evaluated the results of the technical reviews and scored the systems based on a weighted scoring process.

DFAS consolidated the data provided during the review process and recommended to the DBOF Corporate Board that the systems be designated as interim migratory accounting systems. The accounting systems approved by the DBOF Corporate Board and listed in a memorandum issued by the Under Secretary of Defense (Comptroller) are shown in Table 1.

**Table 1. Systems Initially Selected as
Interim Migratory Accounting Systems**

Component	Business Area	Selected Accounting System
Army	Depot Maintenance	Standard Industrial Fund System
	Retail Supply	Standard Army Financial Inventory Accounting and Reporting System
	Wholesale Supply	Commodity Command Supply System
Navy	Depot Maintenance & Research & Development	Naval Air Systems Command Industrial Fund Management System
	Retail Supply	Uniform Automated Data Processing System
	Wholesale Supply	Material Financial Control System
Air Force	Depot Maintenance	Depot Maintenance Management Information System
	Retail Supply	Standard Material Accounting System
	Wholesale Supply	Financial Inventory Accounting and Billing System
DLA	Retail Supply	Base Operations Support System
	Wholesale Supply	Standard Automated Material Management System
	Subsistence Commodity	Defense Integrated Subsistence Management System
	Fuels Commodity	Defense Fuels Automated Management System
Other DBOF	Information Processing	Industrial Fund Accounting System
	Multiple Business Areas	Defense Business Management System

In addition to the selected accounting systems, the Under Secretary of Defense (Comptroller) made the following stipulations.

- o A cost analysis would be completed before any substantial work could begin on correcting the interim migratory accounting systems.

Consolidating and Correcting WCF Accounting Systems

- o A functional economic analysis would be required between two systems for the Transportation business area (the Corps of Engineers Financial Management System was selected on May 28, 1996, as the interim migratory accounting system to support the Transportation business area).

- o A functional economic analysis would be performed for the depot maintenance business area to select between two approaches. The first approach would designate three separate depot maintenance systems to be used by the individual Military Services. The second approach would designate one standard depot maintenance accounting system (the Logistics Management Institute published the results of the functional economic analysis in April 1996 and concluded that each Military Service should retain a separate accounting system until depot maintenance production systems were standardized).

- o A commercial off-the-shelf system would be selected for the Publications and Printing and Public Works business areas (the contract for the commercial off-the-shelf system was awarded on April 18, 1996).

In summary, DFAS and the Military Services conducted an extensive accounting system evaluation process during 1994 to select the best interim migratory accounting systems available to support the WCF. The selections were approved by the DBOF Corporate Board and the Under Secretary of Defense (Comptroller) in December 1994.

Reducing the Number of Accounting Systems

DFAS made progress in eliminating legacy accounting systems. The original Strategy called for the elimination of 65 legacy accounting systems. The elimination of these legacy accounting systems is crucial if DFAS is to reduce system operating costs and minimize the funds needed to correct accounting system deficiencies. Between February 1994 and January 15, 1997, 15 legacy systems had been eliminated.

Changes Made to WCF Systems Strategy

Modifications Made to the Strategy. The Strategy has been significantly modified since it was developed and approved in February 1994 and since accounting system selections were approved in December 1994. Plans for 76 percent of the original interim migratory accounting system selections changed are going through additional evaluations for reconsideration as interim migratory accounting systems or are being evaluated to determine their capabilities to support both wholesale and retail supply activities within the Military Services. Of the original 17 accounting systems selected as interim migratory accounting systems, 3 have been redesignated legacy systems, 5 are being reconsidered for inclusion in the Strategy, 2 are being studied for possible merger, and 3 will have to change their original approach to system enhancements. These modifications were made to accommodate various Military Services and Defense agency initiatives and also to identify more efficient options to meet accounting system requirements. Table 2 depicts the

Consolidating and Correcting WCF Accounting Systems

original systems that were redesignated legacy systems and Table 3 identifies the status of systems that have undergone further evaluations. The question marks in Tables 2 and 3 indicate that no system selection has yet been made.

Table 2. Original System Selections Redesignated Legacy Systems

Business Area	Original Selection	Current System
Navy		
Retail Supply	UADPS	MFCS
Air Force		
Depot Maintenance	DMMIS	?
DLA		
Fuels Commodity	DFAMS	FAS

Table 3. Status of Systems that have Undergone Further Evaluations

Business Area	Original Selection	Status	Current System
Army			
Wholesale Supply	CCSS	To support single stock fund	CCSS
Retail Supply	STARFIARS-MOD	To support single stock fund	STARFIARS-MOD
Navy			
Wholesale Supply	MFCS	Consolidate supply management systems	MFCS
Air Force			
Wholesale Supply	FIABS	Potential merger with SMAS	?
Retail Supply	SMAS	Potential merger with FIABS	SMAS
DLA			
Wholesale Supply	SAMMS	Upgrade on hold pending review	?
Retail Supply	BOSS	Upgrade on hold pending review	?
Subsistence Commodity	DISMS	Upgrade on hold pending review	?
Other			
Information Processing	IFAS	Upgrade on hold pending review	?
Multiple	DBMS	Upgrade on hold pending review	?

Consolidating and Correcting WCF Accounting Systems

The following is a discussion of the changes made to the Strategy and the status of interim migratory accounting system selections.

Interim Migratory Accounting Systems Redesignated as Legacy Systems. Three of the accounting systems originally selected under the Strategy have been redesignated as legacy systems.

Navy Supply Management Business Areas. The Uniform Automated Data Processing System was originally selected as the interim migratory accounting system for Navy retail supply management but has since been redesignated as a legacy system. During the December 1995 DBOF Corporate Board meeting, Naval Supply Systems Command personnel presented a proposal to consolidate Navy wholesale and retail supply accounting systems. Navy personnel advised the DBOF Corporate Board that systems development and labor costs could be reduced by using the Material Financial Control System, which was the interim migratory accounting system selected for both the wholesale and retail supply management business areas. The DBOF Corporate Board accepted the Navy proposal and the Uniform Automated Data Processing System was subsequently redesignated as a legacy system.

In response to the DBOF Corporate Board decision to consolidate Navy wholesale and retail supply management accounting systems, DFAS revised the Strategy. As of June 1997, DFAS personnel were conducting studies to develop a plan to add the required functionality to the Material Financial Control System, implement the accounting system at Navy retail supply sites, and to estimate the time frames and costs associated with consolidating the two Navy business areas.

DLA Fuels Management Business Area. The Defense Fuels Automated Management System, which was originally selected as the interim migratory accounting system to support the fuels management business area, was redesignated as a legacy system in 1996. The Fuels Automated System replaced the Defense Fuels Automated Management System as the interim migratory accounting system. The Defense Logistics Agency established the Fuels Automated System migratory program in response to new responsibilities defined by the Office of the Assistant Secretary of Defense (Logistics). The new responsibilities included management and accountability for fuel stored at installations, which was previously the responsibility of the Military Services. The Defense Logistics Agency received approval from the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) in January 1996 to proceed with concept exploration and definition of life-cycle management for the Fuels Automated System as the migratory accounting system to support the Defense Logistics Agency fuels management business area. Although the Fuels Automated System Program Management Office planned to complete the implementation of the system by the third quarter of FY 1998, the program office acknowledged that the estimated completion date may be too optimistic given the integration that must take place between multiple modules from different vendors that have never been used together.

Air Force Depot Maintenance Business Area. The accounting system recommended for Air Force depot maintenance was redesignated as a

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legacy system in 1996. In September 1994, the depot maintenance review team issued "A Report on the Comparative Evaluation of the Candidate Interim Migratory System for the Depot Maintenance Business Area," which recommended the Depot Maintenance Management Information System as the interim migratory accounting system for Air Force depot maintenance. At the November 1994 DBOF Corporate Board meeting, the Commander, Joint Logistics Systems Center recommended that the Corporate Board consider the possibility of approving the Depot Maintenance Management Information System as the migratory accounting system for all DoD depot maintenance. The Joint Logistics Systems Center was in the process of developing the Depot Maintenance Management Information System as the single depot maintenance information system with both production and accounting capabilities.

As a result of the November 1994 DBOF Corporate Board meeting, the Under Secretary of Defense (Comptroller) required a functional economic analysis of the depot maintenance business area before any work could begin on the depot maintenance interim migratory accounting systems recommended by the review team. The Logistics Management Institute performed the functional economic analysis which compared two options: option one was to move to a separate accounting system for each of the three Military Departments and option two was to move to a single system for all DoD depot maintenance. In August 1995, the Acting Deputy Under Secretary of Defense (Logistics) issued a memorandum that changed the focus of the implementation initiatives from a single depot maintenance system to separate system plans for each Military Service. The Air Force was to continue to implement the Depot Maintenance Management Information System.

The Logistics Management Institute issued their report in April 1996 and concluded that option one was preferable because depot maintenance accounting systems could not be standardized until depot maintenance production systems were standardized. The Logistics Management Institute recommended that the DBOF Corporate Board consider options to the Depot Maintenance Management Information System as the interim migratory accounting system for Air Force depot maintenance. This recommendation was based on the conclusions that the Depot Maintenance Management Information System financial subsystems did not work properly, the costs of fixing the financial subsystems were unknown but probably high, and the financial subsystems would not cover all the workload to support Air Force depot maintenance. Also in April 1996, the Air Force Material Command canceled the Depot Maintenance Management Information System development initiative. Since April 1996, DFAS and the Air Force had been studying potential accounting systems for the Air Force depot maintenance business.

Interim Migratory Accounting Systems Under Reconsideration. Five of the accounting systems originally selected as interim migratory accounting systems were being reconsidered. As of June 1997, the analyses of alternatives for the accounting systems were still in progress and no final decisions were made to either proceed with the original accounting system selections or revise the Strategy.

The Defense Logistics Agency Business Areas. The four accounting systems originally selected under the Strategy to support all the Defense

Consolidating and Correcting WCF Accounting Systems

Logistics Agency business areas, except fuels management, were being reconsidered. The Defense Logistics Agency accounting systems that were being reconsidered are in Table 4.

Table 4. DLA Interim Migratory Accounting Systems Being Reconsidered

Business Area	Accounting System
Retail Supply Management	Base Operations Support System
Wholesale Supply Management	Standard Automated Material Management System
Subsistence Commodity	Defense Integrated Subsistence Management System
Multiple Business Areas	Defense Business Management System

Personnel from the DFAS Columbus Center informed us that they proposed the concept of a common accounting module to support the Defense Logistics Agency business areas in 1996 as an alternative to the accounting systems selected under the original Strategy. DFAS Columbus Center personnel made this proposal for two primary reasons. First, the estimated cost to enhance the Defense Integrated Subsistence Management System accounting module increased from \$1.9 million to \$3.3 million. Second, there was mixed ownership of the Base Operations Support System, the Standard Automated Material Management System, and the Defense Integrated Subsistence Management System. The financial modules of these systems were owned by DFAS and the logistics modules were owned by the Defense Logistics Agency. DFAS Columbus Center personnel felt that it was preferable for DFAS to have full ownership and control of the accounting systems. Also, DFAS personnel stated that the costs to operate and maintain one system versus four systems appeared to be significantly beneficial.

DFAS awarded a contract during February 1997 to study alternatives to the original Strategy to correct the accounting system deficiencies that support the Defense Logistics Agency. The Program Management Office withheld approximately \$11 million of FY 1997 funds planned for system changes from the DFAS Columbus Center system program offices until the study was completed and a final decision made.

Information Processing Business Area. The Industrial Fund Accounting System, which was initially selected as the interim migratory accounting system for the information processing business area, was being reconsidered. DFAS personnel stated that costs to enhance the Industrial Fund Accounting System both functionally and technically were significant and an analysis of a commercial off-the-shelf alternative was deemed appropriate to determine whether there was a more cost effective and timely solution. In discussions with the Industrial Fund Accounting Systems program manager, we were informed that approximately \$1.1 million of FY 1997 funds were being withheld by the Program Management Office. The Industrial Fund Accounting System program manager requested these funds to correct the accounting system deficiencies to bring the system into compliance by the end of FY 1997. Personnel from the Program Management Office informed us that they planned

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to analyze alternatives and would withhold the funds until the study was complete and a final system selection made. DFAS estimated they would not complete the analysis of alternatives before July 1997 at the earliest.

Air Force Supply Management Business Areas Studied for Merger. Two interim migratory accounting systems initially selected to support Air Force supply management business areas were being studied for possible merger. Personnel from the DFAS Denver Center were studying the feasibility of merging the Standard Material Accounting System, which was to support Air Force retail supply management, and the Financial Inventory Accounting and Billing System, which was to support Air Force wholesale supply management. The study was not expected to be completed before July 1997 at the earliest. DFAS withheld \$1 million of FY 1997 funds to correct accounting system deficiencies for the Financial Inventory Accounting and Billing System program offices until the study was completed.

Army Supply Management Business Areas. The approach initially planned for the Army supply management interim migratory accounting systems will be changed. The Commodity Command Supply System was initially selected as the interim migratory accounting system for the Army wholesale supply business area, and the Standard Army Financial Inventory Accounting and Reporting System was initially selected as the interim migratory accounting system for the Army retail supply business area. The Army Material Command proposed changing supply management operations to a single stock fund concept. The Army Material Command established the Single Stock Fund Corporate Board in August 1996 to manage the development, implementation, and operations on the single stock fund concept throughout the Army. Although plans for the single stock fund were early in their development, the Single Stock Fund Corporate Board established a completion date of September 1998.

The single stock fund concept will affect the functionality and support provided by the accounting systems. The program offices for the Commodity Command Supply System and the Standard Army Financial Inventory Accounting and Reporting System were coordinating with the Army Material Command to identify changes needed to the selected accounting systems to support the single stock fund. However, the plans for implementation and support of the single stock fund were too early in development to be able to identify the affect this will have on the overall Strategy.

Additional WCF System Selections

We also reviewed plans for four other WCF interim migratory accounting systems. These systems were:

- o the Standard Industrial Fund System for the Army depot maintenance business area,
- o the Navy Industrial Fund Management System for the Navy depot maintenance and research and development business areas,

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- o a commercial off-the-shelf system for the Navy printing and publications and public works business areas, and
- o the Corps of Engineers Financial Management System for the transportation business area.

The initial system selections had not changed for these business areas.

Accounting Requirements

The financial statements are prepared based on requirements that are found within various levels of a hierarchy of accounting standards. These levels include the Statements of Federal Financial Accounting Standards and Concepts, known as Federal Generally Accepted Accounting Principles, that are adopted by U.S. Treasury, the Office of Management and Budget, and the General Accounting Office; interpretations of the Federal Generally Accepted Accounting Principles published by the Office of Management and Budget; Office of Management and Budget Form and Content; and generally accepted accounting principles and other authoritative standards. Also, DFAS established the 13 Key Accounting Requirements that all accounting systems must eventually meet. As DFAS continues to evaluate interim migratory accounting systems, the abilities of the systems to meet these requirements should be a major factor in deciding system selections.

Summary. Although the Program Management Office exercised management control by withholding funds that were to be spent on interim migratory accounting systems that were being reconsidered for being part of the Strategy, DFAS was still in the process of updating their plans to correct DBOF accounting systems. DFAS cannot develop implementation plans or estimate the realistic time frames and costs for correcting WCF accounting systems until the Strategy is updated and final accounting system selections are made. It is critical for DFAS to consider the ability of the systems to meet the various accounting requirements when evaluating and selecting WCF interim migratory accounting systems.

Completeness of the Strategy

The Strategy was incomplete because it did not include all systems that support each of the WCF business areas. The underlying feeder systems that provide substantial amounts of data were not considered when attempting to correct the accounting system deficiencies associated with the business areas. Also, the Strategy did not include plans for a system to support the Air Force depot maintenance business area or departmental accounting. The realistic time frames and costs to complete the Strategy cannot be identified until all systems that provide financial transactions are included as part of the Strategy and until detailed development and implementation plans are established.

Strategy Only Includes Primary Accounting Systems. The Strategy only included the primary accounting systems and did not include all systems that supply data that create financial transactions for the individual business areas.

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For example, the Standard Material Accounting System relied on input from approximately 10 different financial and non-financial systems. Some of these feeder systems were owned by DFAS while other feeder systems were owned and operated by the Air Force. Only the Standard Material Accounting System was included in the Strategy as a system in need of modifications to comply with WCF and CFO reporting requirements. Figure 2 shows the flow of data to and from the Standard Material Accounting System.

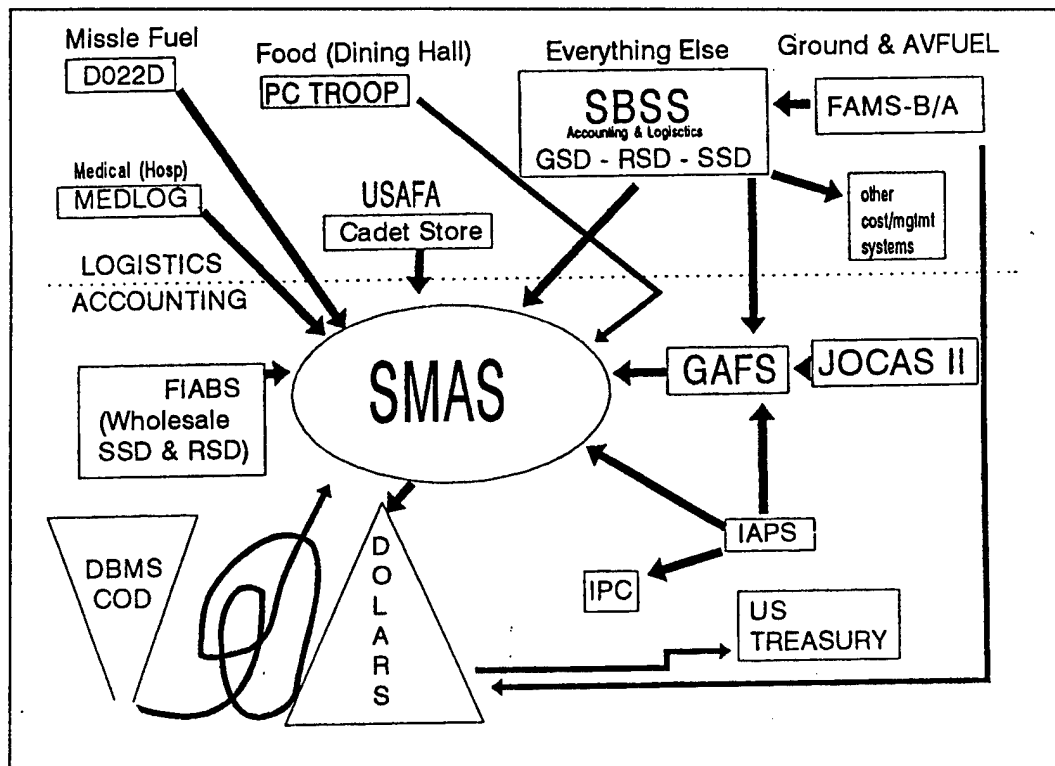


Figure 2. Standard Material Accounting System Data Flow

The reliability of the accounting data within a business area depends on all the systems through which the data flows. To correct all accounting deficiencies within a given business area, the Strategy should be focused on all the systems that comprise the individual business areas and not just the primary accounting system. Auditable financial statements will only be possible through the joint efforts of DFAS, the Military Services, and Defense agencies to correct deficiencies in all accounting and feeder systems.

Business Area Without a Selected Interim Migratory Accounting System.

As previously discussed, the Depot Maintenance Management Information System, which was initially selected as the interim migratory accounting system to support Air Force Depot Maintenance, was canceled by the Air Force Material Command in April 1996. At the time of our audit, the Program Management Office had not yet identified an alternative plan and an interim migratory accounting system for the Air Force depot maintenance business area.

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Air Force Contract Depot Maintenance. The Strategy did not include systems that support Air Force Contract Depot Maintenance. The Air Force Depot Maintenance business area under the WCF includes both organic workload and contract workload. Organic depot maintenance work is performed by Air Force personnel whereas contract depot maintenance workload is performed by DoD contractors. The Strategy is focused on reviewing accounting systems that would support only the organic side and not the contract side. Contract depot maintenance accounts for about 40 percent of Air Force depot maintenance activity.

Standard System for Departmental Accounting. DFAS had not identified an accounting system to perform departmental accounting functions. DFAS initially planned to implement one standard accounting system for WCF departmental accounting and another standard accounting system for general fund departmental accounting. The Central Data Base had been chosen as the standard WCF departmental accounting system and the program office began establishing plans to deploy the system to the DFAS Centers. However, DFAS changed its departmental accounting system strategy and planned to select and implement a single accounting system to perform all departmental accounting functions: both WCF and general fund. DFAS is in the process of reviewing departmental accounting systems.

Summary. Since its inception the Strategy was, and continues to be, an incomplete plan to correct accounting system deficiencies because it only included the primary accounting systems -- not the feeder systems. Also, the Strategy did not include accounting systems supporting the Air Force depot maintenance business area or the departmental accounting function. DFAS cannot estimate realistic time frames or costs for achieving auditable financial statements until detailed plans are updated to include all systems that supply and process data to be reported on the WCF financial statements.

Actions Taken by DFAS after Completion of Audit Work

Since the completion of our audit field work in March 1997, personnel from the Program Management Office informed us that they have taken actions to strengthen the Strategy. DFAS devised a four-part strategy for enhancing DoD financial management systems to bring them into compliance with Federal requirements. First, DFAS is completing a comprehensive compilation of requirements for financial management systems, including both accounting and feeder systems. This compilation is intended to be used as a tool by DoD systems managers in developing and/or modifying financial management systems. Second, DFAS has been working with the Military Services to identify DoD critical financial management systems. Such systems are the most important to the Department in ensuring that DoD (1) fulfills its constraints levied by the Congress, (2) produces reliable financial reports/statements, and (3) assists decisionmakers, including the Congress. Third, the critical financial management systems will be modified/enhanced by their owners to comply with federal requirements. Fourth, once the systems have been developed and/or modified, independent assessments of the systems' compliance with requirements must be made.

Summary

DFAS made progress in reducing the number of WCF accounting systems by eliminating 15 legacy systems since the Strategy was put in place in February 1994. The continued elimination of legacy systems is crucial if DFAS is to reduce system operating costs and minimize the funds needed to correct accounting system deficiencies. However, since the original Strategy was approved in February 1994 and the initial system selections were made in December 1994, the Strategy has been significantly modified. In the case of the WCF systems strategy, 3 of the original selections have been redesignated legacy systems and will be replaced by other interim migratory accounting systems. The DFAS is reconsidering 5 of the original selections to determine whether an alternative plan would better support the DLA and information processing business areas. Finally, DFAS is evaluating changes required to the Strategy's detailed plans in order to merge the wholesale and retail supply management interim migratory accounting systems. The modifications were made to accommodate various Military Services and Defense agency initiatives and to identify more efficient options to meet accounting system requirements.

The Strategy was incomplete because it did not include all systems that support the individual business areas. The Strategy was only focused on the primary accounting systems. Each business area was supported by multiple financial and non-financial systems, most of which were not considered as part of the Strategy. The accuracy of the accounting data depends on the proper input and processing of data through all the systems that comprise the individual business areas. Auditable financial statements will only be possible through the joint efforts of DFAS, the Military Services, and Defense agencies to correct deficiencies in all accounting and feeder systems. DFAS cannot estimate the realistic time frames or costs for completing the Strategy and for producing auditable WCF financial statements until the Strategy is updated, final accounting system selections are made, and all systems that comprise, or provide significant input to, the WCF business areas are included in the Strategy. Since the completion of our audit field work in March 1997, management actions were taken to strengthen the Strategy for correcting accounting and feeder system deficiencies.

Recommendations

Deleted and Renumbered Recommendations. As a result of discussions with personnel from the Office of the Under Secretary of Defense (Comptroller), we deleted draft Recommendation 1. Draft Recommendations 2. and 3. have been renumbered as Recommendations 1. and 2., respectively.

We recommend that the Under Secretary of Defense (Comptroller):

a. Finalize selection of the WCF interim migratory accounting systems and update detailed plans, including cost estimates and time frames, to implement the systems selected for long-term use.

b. In coordination with the DoD Chief Information Officer and DoD functional managers, update the Strategy to include detailed plans to correct all Military Service and Defense agency feeder systems that support each WCF business area.

Management Comments Required

The Under Secretary of Defense (Comptroller) did not comment on a draft of this report. We request the Under Secretary of Defense (Comptroller) provide comments on the final report by January 9, 1998.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. We limited our review of the WCF Interim Migratory Accounting Strategy to systems used for WCF accounting. The WCF reported a combined \$92.2 billion of assets on the FY 1996 financial statements. We interviewed personnel involved in establishing and carrying out the Strategy. We examined and analyzed plans established for each WCF interim migratory accounting system. Our analysis included, but was not limited to, review of time frames established for,

- o correcting system deficiencies,
- o deploying corrections,
- o replacing legacy systems with interim migratory systems, and
- o implementing the Key Accounting Requirements.

Additionally, we reviewed strategic business plans and cost estimates provided by DFAS and analyzed budget data for 17 accounting systems. The scope of the audit was limited in that we did not review the management control program because DoD has recently reported financial management systems as a high risk area.

Audit Period and Standards. We performed this financial related audit during the period June 1996 through March 1997. This audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program

We did not review the management control program as it related to the WCF accounting systems because financial statement audits required by the Chief Financial Officers Act provide sufficient coverage of the WCF management control program. Additionally, the objectives concerned planning and policy issues rather than control techniques.

Appendix B. Summary of Prior Coverage

No prior audit reports have specifically addressed the WCF Interim Migratory Accounting Strategy established by the DFAS. However, three reports summarized audit reports which identified deficiencies in DBOF accounting systems. None of the three reports contained recommendations because other reports included numerous recommendations.

IG, DoD, Report No. 98-002, "A Status Report on the Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund for FY 1996," October 3, 1997. This report provides a global perspective of the significant systemic accounting and management control problems that affected the DBOF.

IG, DoD, Report No. 97-006, "Major Accounting and Management Control Deficiencies in the Defense Business Operations Fund in FY 1995," October 15, 1996. This report identifies and summarizes the major accounting and management control deficiencies in the DBOF management control structure that prevented timely development and reliable presentation of the Fund's financial statements. The report groups deficiencies identified by auditors into three categories; accounting systems, control procedures, and control environment. This report also provided the status of corrective actions.

IG, DoD, Report No. 95-294, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," August 18, 1995. This report groups the deficiencies into the categories of accounting systems' characteristics; policy guidance; Property, Plant, and Equipment; inventory valuation and classification of accounts; and personnel.

Appendix C. Key Accounting Requirements

The DFAS established 13 Key Accounting Requirements, which all interim migratory accounting systems must implement as part of the Strategy.

Key Accounting Requirements

General Ledger Control and Financial Reporting. The system must have general ledger control and maintain an appropriate account structure approved by DoD. The general ledger account structure must follow the general ledger accounts for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources. A double entry set of accounts must be maintained within the system to reflect budget authority, undelivered orders, obligations, expenditures, and other necessary accounts. The system must list both control and subsidiary general ledger accounts by title and numbers with definition of each account. Subsidiary accounts shall be reconciled to the control accounts at least monthly.

Full financial disclosure, accountability, adequate financial information, and reports must be provided for management purposes, and for necessary external reporting to OMB and Treasury. General ledger control and financial reports apply to all DoD systems except pay delivery systems, including stock, industrial, and trust funds.

Property and Inventory Accounting. The system must account in quantitative and monetary terms for the procurement, receipt, issue, and control of plant property, equipment, inventory, and material. Most acquisitions are recorded upon receipt of goods.

All property and equipment including ADP software with an initial acquisition cost of \$5000 and an estimated useful life of more than 2 years must be capitalized and reported at cost including amounts paid to install the assets in the proper form and place. If cost is unknown, the fair value of the fixed asset at the date of acquisition is estimated. Costs of additions, alterations, or replacements that extend the asset's useful life or service capacity are capitalized as fixed assets. Proper accounting controls exist for Government-owned property held and used by contractors.

Inventory accounting must entail accounting and control over the acquisition and issuance of materials, the comparison of physical inventories and records, the planning for procurement and utilization, and effective custody of the materials. The property management system must include accounting controls over inventory ledgers that identify the item, its location, quantity, acquisition date, cost, and other information. Subsidiary property records are reconciled

Appendix C. Key Accounting Requirements

periodically to general ledger accounts. Physical controls include assigning specific individuals to inventory, placing physical safeguards on inventory, and periodically reconciling physical inventories to the accounting records.

Accounting for Receivables Including Advances. The system must account for all accounts receivables (any public indebtedness to the U.S. Government). Accounts receivable shall be recorded accurately and promptly to provide timely and reliable financial status. Accounts receivable shall be reduced upon collection of funds or when offset by previously established collateral. Uncollectible amounts should be promptly written off and the accounts receivable reduced accordingly. An allowance for uncollectible accounts and corresponding expenses must be established to provide full financial disclosure. The process should document the efforts made to collect delinquent debts (this includes compliance to the Debt Collection Act).

All collections shall be under general ledger accounting control. Cash shall be deposited as expeditiously as possible and immediately recorded in the accounting records.

Advances shall be recorded as assets until receipt of the goods or services or until contract terms are met. Accounting control must be maintained over advances made to employees, contractors, and all others. Advances must be promptly recorded and reconciled to general ledger control accounts.

Cost Accounting. Cost accounting must involve accounting analysis and reporting on costs of production of goods or services, or operation of programs, activities, functions, or organizational units. Cost accounting shall be provided in the accounting system if it is required in such instances as pricing decisions, productivity improvement decisions or measurement of performance, efficiency comparisons of like activities, and in industrial fund activities. For industrial fund activities, there is a DoD requirement for working capital funds to provide capital for industrial type and commercial type activities. Industrial fund accounting shall provide an effective means for controlling the cost of goods and services produced or furnished by industrial and commercial type activities. Cost accounting should be used in job order and process cost and in determining operating results. The primary components of DoD costs are labor and materials. However, other costs such as depreciation, amortization, unfunded liabilities such as severance pay, labor, manufacturing overhead, unallocated costs, etc., should be accumulated in the accounting system when needed.

Accrual Accounting. Accrual accounting must recognize the accountable aspects of financial transactions or events as they occur. Transactions may be recorded in accounting records as they occur or be adjusted to the accrual basis at each month end. Accrual accounting should be used to meet the specific needs of management and the Congress.

Amounts of accrued expenditures and revenues must be recorded only when supported by prescribed documentary evidence on the basis of initial documentation received. They are adjusted subsequently, if necessary, upon

Appendix C. Key Accounting Requirements

receipt of more accurate documentation. Examples of acceptable initial documentation received include receiving reports, bills of lading, job sheets, certified unpaid invoices and journal vouchers showing administrative estimates by responsible officials. This documentation shall represent a reflection of transactions and performance which actually occur.

When liabilities are incurred as work is performed rather than when deliveries are made, accruals must be recorded from performance reports for the affected accounting period. Unpaid personnel compensation and benefits which have been earned as of the end of the pay year must accrue in full or in part, for example, the accrual of annual leave is material and should be recognized annually in the financial statements. Accrued payroll for civilian and military for salaries and wages, employer's share of fringe benefits, allowances, foreign nationals, severance pay, unfunded annual leave, annual leave, and retirement must be recorded and reconciled with actual payroll.

Military and Civilian Payroll Procedures. Wherever feasible, DoD will use modern technology in its computer systems to process payroll transactions. The payroll system will interface with the accounting system providing obligation and accrual data. The military and civilian payroll processes and procedures must be available to management, users, auditors, evaluators, etc.

Payroll systems must incorporate controls of both gross and net payroll amounts and payroll deductions to ensure smooth payroll processing action and to minimize incorrect payments. Procedures will be available to ensure that only authorized deductions are made from pay and all deductions are supported by proper documentation. Accounting entries for authorized deductions from pay must be verified. Timely, accurate, and complete individual and subsidiary records are maintained for leave accounts, employee benefits, compensated personnel absences, general benefits such as bonuses and cash allowances for quarters and subsistence, allotments by type and amounts, and other balances. Reconciliations of the general ledger and personnel records to payroll records will be performed.

Unpaid personnel compensation and benefits, including annual leave, which have been earned by employees as of the end of the pay year must be accrued in full. Accrued payroll will be reconciled with actual payroll.

Personal compensation and all employee benefit expenses (including federal contributions) shall be reported and disclosed separately in financial statements. Automated controls will include predetermining limits on the computation of pay; accumulation and tests of zero balances; checks on sequence of records; counts of records; crossfoot balances; and other tests of the validity of the data or accuracy of the processing. Separation of duties is promoted by requiring vouchers authorizing payment to be certified before payment by a duly authorized certifying officer who does not compute amounts payable, maintain the payroll records, or distribute the paychecks.

Appendix C. Key Accounting Requirements

System Controls (Fund and Internal)

Fund Control. The system must ensure obligations and expenditures do not exceed the amount appropriated, apportioned, reapportioned, allocated and allotted (Anti-Deficiency Act 31 U.S.C.). The system must provide a process and procedures for control over errors to ensure that once errors are detected: (1) corrections are made in a timely manner and reentered into the appropriate processing cycle; (2) corrections are made only once; and, (3) the correction itself is validated. The system must show the appropriations and funds to be accounted for and a description of the accounting entity's proposed fund distribution and control process. The system must have good fund control procedures to prevent untimely liquidation of obligations, unmatched expenditures, and undistributed disbursements.

Obligations must be recorded immediately. Fund control procedures must include fiscal year end Section 1311 Statement of Certification by a senior accounting official to ensure the validity of all obligations and unobligated balances. Administrative funds control must ensure that funds are used economically, efficiently, and only for properly authorized purposes.

Internal Controls. The system must have adequate internal controls to prevent, detect, and correct errors and irregularities that may occur throughout the system. Separation of duties and responsibilities must be maintained for initiating, authorizing, processing, recording, and reviewing transactions. Automated systems must have system security and integrity for authorized processing to include procedures and controls which protect hardware, software, and documentation from physical damage by accident, fire, flood, environmental hazards, and unauthorized access. Also, the system must have controls to prevent unauthorized use of confidential information.

Audit Trails. Audit trails permit tracing transactions through a system. Audit trails allow auditors or evaluators to ensure transactions are properly accumulated and correctly classified, coded and recorded in all affected accounts. Audit trails should allow a transaction to be traced from initiation through processing to final reports. In addition, good audit trails allow for the detection and tracing of rejected or suspended transactions, such as unmatched disbursements, for ultimate systematic correction in a reasonable time frame.

A fundamental requirement for any compliant accounting system is that the financial transactions for which the system must account be adequately supported with pertinent documents and source records. All transactions, including those which are computer-generated and computer-processed, must be traceable to individual source records. Audit trails enable the tracing or replicating of a transaction from its source to the resulting record or report, and from the resulting record or report to the source. Items in source records necessary for audit-trail purposes include transaction type, record or account involved, amount, processing references, and identification of the preparer and approver of the transaction. A key test of the adequacy of an audit trail is

Appendix C. Key Accounting Requirements

whether tracing the transaction forward from the source or back from the result will permit verification of the amount recorded or reported.

Cash Procedures and Accounts Payable. The system shall be designed to ensure timely payments based on properly approved disbursement documents. Payment process and procedures must comply with the Prompt Payment Act. Cash discounts should be taken when determined to be financially advantageous to DoD.

Accounts payable are liabilities which should be recorded when goods or services are received. The liability reported in the annual financial statements shall reflect amounts due for goods and services received. For items manufactured by a contractor to specification, the accounting system shall reflect the appropriate payable, including contract retentions, for each accounting period based on requests for progress payments or on reasonable estimates of unbilled contractor performance. This shall be recorded in the proper accounting period.

Accounts payable for services performed by employees, contractors, and others shall be determined based on performance as evidenced by payroll records, progress billings, or other available data. Reasonable estimates of the cost of services performed before the end of a reporting period shall be made for annual financial reporting purposes in the absence of invoices or other available data. The system shall record the liability for goods and services purchased under a long-term contract in the period in which the goods or services are received or accepted.

System Documentation. The accounting system must have adequate system documentation which must include interfaces between accounting system segments. The detailed accounting system design package shall adequately document the functional user's accounting requirements. Such documentation must be available in users manuals, subsystem specification, etc. The detailed documentation must be comprehensive and shall include a combination of descriptions of processes, flowcharts and narrative description, diagrams, basic accounting entries including adjusting and closing entries, illustrations or samples of source documents for input, and sample outputs and reports. It shall also include internal controls incorporated within the accounting system. The documentation must demonstrate conformance with DoD requirements for adequate and reasonable documentation. The system documentation shall be in enough detail to be understood by computer personnel and/or system accountants assigned to develop applicable software or review process flow. It shall demonstrate readily to users, auditors, and evaluators the system's conceptual processes and procedures. The documentation should be in good order to facilitate maintenance operations and transaction testing. Good documentation would permit transaction testing which is designed to disclose whether valid transactions are processed properly, and whether the system rejects invalid transactions. The documentation shall have enough detail that a testing of the system could cover an entire transaction, from initial authorization through processing, posting to the accounts, and reporting. The documentation

Appendix C. Key Accounting Requirements

should indicate the mission, organization, description, objectives, financial management requirements, and boundaries of the system.

System Operations. Adequate organization and planning shall exist regarding systems operations to assure that financial management and accounting objectives are met in an economical and efficient manner. It must satisfy legal requirements, laws, regulations, accounting principles and standards, and related requirements as prescribed by GAO, OMB, and DoD. Financial systems shall contain all data required to achieve the purposes for which they were created and maintained. They shall also be as simple as possible, consistent with regulatory requirements and users' needs. The existing and planned hardware should be adequate to process efficiently current and projected future transaction volumes. There should be compatibility of existing and planned hardware to interface effectively with other systems. The system should conform to required DoD systems documentation requirements. The best of acceptably priced contemporary technology should be used. There should be detailed system operating and maintenance procedures. Also, there should be periodic system reviews to assure that the system is functioning as intended, required procedures are being followed, any operating problems are promptly identified and corrected, and possible state-of-the-art enhancements are incorporated as appropriate.

User Information Needs. User information needs and requirements as to quality, accuracy, timeliness, reliability, responsiveness of the system shall be adequate in response to program, financial managers, and other users. The system shall satisfy users as to their reporting requirements particularly as it relates to month end reports. The system must also satisfy user needs to facilitate their management decision making process. In addition, if there are departures in other KARs that adversely impact the users of the system, the materiality of these departures will be determined under this KAR.

Budgetary Accounting. The system shall support formulation of the budget, support budget requests, and control budget execution. Programming, budgeting, accounting, reporting classification, and coding structure should be uniform and consistent with each other and synchronized with the organizational structure so that actual activity reported within the accounting system can be compared with enacted budgets and support future budget formulation for each activity. Presidential, Congressional, and OMB decisions shall be recorded in the system, the financial management data and results shall be appropriately classified to track such decisions. The system shall record budget resources at the appropriate level and account for appropriations, reappropriations realized, apportionments, allocations, transfers, allotments of budget authority, customer orders accepted, reimbursables, and other appropriate accounts prescribed by DoD.

Appendix D. Report Distribution

Office of the Secretary of Defense

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Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
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House Committee on Government Reform and Oversight
House Subcommittee on Government Management Information and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
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